

**Testimony of Tom Sanzillo
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**Before the Puerto Rico House of Representatives Commission on Economic Development, Planning,
Telecommunications, Public-Private Partnerships and Energy
April 6, 2021**

Chairman Torres and members of the committee:

Thank you for the opportunity to testify today. My name is Tom Sanzillo, and I am the Director of Financial Analysis for the Institute for Energy Economics and Financial Analysis. IEEFA has been closely following and analyzing Puerto Rico electrical system issues since 2015. Our publications have focused on the physical and financial condition of the Puerto Rico Electric Power Authority (PREPA), specifically pre- and post-hurricane energy planning and priorities, debt management, consultant hiring and fee structures, renewable energy opportunities, management challenges, political interference, budget and fiscal plan, federal oversight, fuel oil contracting and other procurement issues and irregularities.

Prior to my tenure at IEEFA, I spent 17 years at senior management levels at the New York City and New York State Comptroller's Offices. I left state service in 2007 as the First Deputy Comptroller of New York State (and served for a short period as the State Comptroller due to an early resignation). In those positions, I had responsibility for the oversight of a \$150 billion pension fund; a 1 million-member retirement system; a \$250 billion state and local bond portfolio; 40,000 annual contracts valued at \$85 billion; the audit program for all public authorities (including the state's largest energy authorities, the Long Island Power Authority and the New York State Power Authority) and state and local governments; monitoring of the state budget and expenditures (including payrolls); and review of the finances of 1,400 units of local government. My work on state government finances has appeared in the New York State Oxford Handbook on Politics and Government.

During my time in state government, I was part of several executive-level initiatives that reviewed, commented on, and approved the financial and organizational redesign of the power system on Long Island. (The oversight work extended over a decade and covered debt restructuring; major contracts including LIPA's management operations agreement; budgeting; audits; and rate setting at what is now the Long Island Power Authority). When I left my position in 2007, LIPA's management asked me to participate as a private citizen on an advisory panel that helped to realign the debt structure.

I am here today to provide testimony related to the LUMA Energy contract. As the committee is well aware, this contract goes far beyond the scope of a transmission and distribution concession and represents a privatization of all of PREPA's non-generation functions. It is also different from a traditional public-private partnership in that LUMA is not required to invest any of its own capital in improvements to the electrical systems.

As described in a report published by IEEFA in October 2020 (attached as Exhibit A to my testimony), our analysis of the contract reveals several fundamental flaws that are likely to prevent Puerto Rico from achieving its goals of an affordable, renewable energy-based electrical system. These flaws include:

- Weak oversight;

- Performance metrics that fail to address fundamental goals, including achieving rates of 20 cents/kWh and a renewable energy standard of 40% by 2025;
- Hidden additional costs not spelled out in the contract; and
- Mismanagement of PREPA's current workforce.

Since our report was published, additional information has come to light revealing:

- Major red flags with the original procurement process;
- Additional hidden costs of the contract;
- More details of LUMA's proposed budgets that indicate there is a high risk LUMA will be unable to keep its pledge of not raising electric rates; and
- New information about federal funding that heightens our concern that the contract will hinder Puerto Rico's ability to meet its renewable energy goals.

Red flags in the procurement of the LUMA Energy contract

Lack of independence of Partnership Committee members

As you know, the evaluation of bids and negotiation of the LUMA Energy contract was conducted by a five-member Partnership Committee. The Partnership Committee was responsible for reviewing bids and scoring them according to various technical, operational and financial criteria. The final scores were used to select the winning bidder.

A review of the individual evaluation documents, obtained via a public information request by the Puerto Rican non-profit organization Cambio and shared with IEEFA (attached as Exhibit B to my testimony), shows that four of the five members of the Partnership Committee arrived at identical numerical scores in 37 of the 38 categories. Three of the members even made the same numerical error in summing their scores. Several of these members noted their scores were based on recommendations by FTI Consulting Inc., an off-island consulting firm hired by the Public-Private Partnership (P3) Authority.

FTI's study, which Cambio received after a second request for information (and which is also included as part of Exhibit B), provided specific scores related to **financial metrics** that appear to have been copied directly from the FTI report onto the scoring sheets. The FTI study does not shed light on how the four Partnership Committee members also arrived at identical scores on the **technical metrics** (which accounted for 45% of the total scoring).

The scoring sheets were then tabulated by the P3 Authority, and the tabulated scores were used by the executive director of the P3 Authority as the basis for a recommendation to vote in favor of LUMA Energy as the winning bidder. In the Partnership Committee's final report, it is represented that on January 11, 2020, the committee met "to (i) discuss the Definitive Proposals, (ii) determine next steps, and (iii) select LUMA as the Preferred Proponent." However, documentation provided by the P3 Authority (see Exhibit C) shows that this "meeting" was actually a unanimous, up-or-down vote over

email to approve LUMA as the preferred proponent, **based solely on the Partnership Committee's scorecards.**¹

Puerto Rico law places great weight on the deliberations of the Partnership Committee.² The Partnership Committee's decision gives the P3 Authority the power to move forward with contract negotiations. The contract and the Partnership Committee's report are submitted to the boards of PREPA and the P3 Authority and then to the governor.

While Puerto Rico law permits consultants to advise the Partnership Committee and the P3 Authority, the consultant-driven process that occurred here is, in my view, a completely inappropriate way to conduct a procurement process. Partnership Committee members should have exercised independent judgment in the review of the bids. Their scores and qualitative assessments should have represented their own views developed after they reviewed the contract submissions. Their analysis could reasonably be assisted by outside parties. However, the conclusions and recommendations of each committee member should have been based on their own judgment, unimpaired by any outside third party.

If an independent review of the contract submissions by a third party was sought by the P3 Authority, it could have served a valuable purpose as an independent check on the work of the five-member committee. For example, after the committee completed its independent review, the chairman and other committee members could have reviewed the FTI report and submitted it to the board with its comments and final recommendations.

Alternatively, FTI Consulting could have been instructed to submit its report directly to the board of the P3 Authority, rather than the Partnership Committee. Under this scenario, the board of the P3 Authority would have been provided with a tool that provided an independent check on the Partnership Committee.

Instead, it appears that the entity largely responsible for awarding this contract to LUMA Energy was effectively FTI Consulting, not the members of the Partnership Committee. It also remains to be seen why the committee's scoring on the technical components of the evaluation were exactly the same for four of the five members.

In my experience reviewing procurement processes for the state of New York as First Deputy Comptroller, I would never have signed off on this agreement had I been aware that committee members had not exercised independent judgment in recommending the award of the contract.

I recommend that this committee develop a separate scope of work and provide staff resources to investigate the selection process that led to the award of the contract to LUMA, especially the work of the Partnership Committee responsible for the evaluation of the proposals submitted. This part of the legislative committee's work might serve the public well if a separate report is prepared that documents the findings. I also recommend the legislature consider appointing an Independent Private Sector

¹ Because the vote was taken via email, there is no record of the Partnership Committee discussing, for example, the finding of the FTI Consulting study that the annual fees in LUMA Energy's original proposal were more expensive for the duration of the contract than what PSEG had proposed. (See p. 5 of FTI Consulting report in Exhibit B).

² See Sections 8 and 9 of [Act 29-2009](#)

Inspector General (IPSIG) for PREPA. IEEFA has previously recommended the imposition of an IPSIG at PREPA to act as an on-site monitor to prevent waste, fraud and abuse.³

Quanta Services conducted federal lobbying during the procurement process

According to federal lobbying disclosure forms, Quanta Energy Services engaged in federal lobbying from the second quarter of 2019 through the second quarter of 2020 on a subject that their disclosures simply listed as “PREPA.” (See Exhibit D to my testimony). This period of time encompasses the period in which Quanta was competing for the T&D concession contract. Quanta held no other contracts with the government of Puerto Rico during this time and, to our knowledge, there is no other PREPA-related subject in which Quanta was engaged. Yet lobbying the federal government in relation to a competitive solicitation process is specifically prohibited by the regulations of the Public-Private Partnerships Authority and explicitly stated in the RFP, unless directed or permitted by the Authority.⁴ Did the P3 Authority direct or permit these activities?

The Puerto Rico Energy Bureau’s chairman played roles in negotiating and approving the contract

As this committee is well aware, the chairman of the Puerto Rico Energy Bureau was one of the members of the Partnership Committee and also cast the deciding vote on the Bureau’s approval of the contract. Thanks to the action of this committee, this issue is pending before the Office of Governmental Ethics and the Puerto Rico Supreme Court. We hope that the committee will continue to follow up on this issue, to ensure that the results of these investigations are made public, and to take whatever subsequent action may be necessary.

Hidden costs to LUMA Energy contract

Since the publication of IEEFA’s report on the LUMA contract last October, information has come to light regarding additional costs that this contract entails for the people of Puerto Rico:

- In December 2020, the Financial Oversight Management Board (FOMB) revealed that PREPA will require an \$894 million loan from the Commonwealth of Puerto Rico to effectuate the transaction.⁵ This money is needed to provide sufficient liquidity to cover expenditures for the

³ IEEFA, “[Carta a la Asamblea Legislativa sobre el Acuerdo de Reestructuración para AEE](#),” October 29, 2019, pp. 19-21.

⁴ Section 4.13(a) of the P3 Authority’s Regulation for the Procurement, Evaluation, Selection, Negotiation and Award of Partnership Contracts and Sale Contracts for the Transformation of the Electric System Under Act No. 120-2018, as amended states “Proponents and Team Members, and their respective Representatives will not, in relation to the Project, an RFQ, an RFP or any other competitive selection process involving PREPA or the Authority, engage in any form of political or other lobbying whatsoever, and will not, except as expressly contemplated by the RFQ or RFP, or as expressly directed or permitted by the Authority, attempt to communicate in relation to any of these matters, directly or indirectly, with any representative of a Partnership Committee, the Authority, PREPA, FAFAA, the Energy Bureau, the Government of Puerto Rico, the FOMB or the Federal Government ...”

⁵ Financial Oversight and Management Board. [Creditor Mediation Cash Support Materials](#). December 17, 2020, p. 24.

first several months of operations, as required by the contract. No information has been provided about the terms of the loan, and it is not referenced in PREPA's certified budget or certified fiscal plan. Even a zero-interest loan would cost PREPA \$60 million annually over the lifetime of the contract, more than enough to wipe out the purported savings from the contract.⁶ Those purported savings have been referenced in public statements by the P3 Authority and the FOMB, but there is no mechanism in the contract to hold LUMA accountable for achieving any savings.

- Second, Citi, the financial consultant to the FOMB, has received a fee of more than \$9 million for the successful execution of the LUMA contract and will receive another \$4.9 million related to the LUMA contract once PREPA exits Title III bankruptcy.⁷ As you know, all of the FOMB's expenses are paid by the people of Puerto Rico.
- Third, as this committee is aware, the LUMA contract has created a workforce crisis by failing to provide for the transfer of PREPA employees into LUMA and failing to recognize the collective bargaining agreements and other employee rights and protections. It is my understanding that as a result of these poor management choices in negotiating the contract, LUMA Energy has received only 1,300 applications from PREPA employees, some of whom may have submitted multiple applications, and 13,000 applications from non-PREPA employees. LUMA Energy has approximately 4,000 positions to fill by June 1.⁸ Under Law 120-2018, PREPA employees who do not take a position with LUMA will be relocated to other positions within the government of Puerto Rico, potentially increasing the commonwealth's labor budget by more than \$200 million annually. Again, this is more than enough to offset any potential savings of the LUMA contract.
- Fourth, it is highly unlikely that PREPA will emerge from Title III bankruptcy before June 1. All of LUMA's costs to participate in PREPA's Title III bankruptcy proceeding will be covered by PREPA customers. This could be an expense on the order of \$5 million to \$10 million annually for LUMA and its attorneys.

As a result of all these factors, I do not find it credible that the LUMA contract will result in any savings at all to the people of Puerto Rico. Nor do I find it likely that LUMA will be able to keep its public pledge of not raising electric rates for the next three years.⁹

LUMA's budget is unrealistic

In February of this year, LUMA filed its proposed initial three-year budget with the Puerto Rico Energy Bureau. IEEFA's analysis of this proposed budget provides indicates a high risk that LUMA will be unable to keep its pledge of not raising electric rates over this period, for the following reasons:

⁶ Repaying an \$894 million loan at zero interest over 15 years would require an annual payment of \$60 million.

⁷ Citigroup. [Third Amended and Restated Engagement Letter between Citigroup Global Markets Inc. and the Financial Oversight and Management Board for Puerto Rico](#). October 7, 2020, p. 4.

⁸ El Nuevo Día. [Presidente de LUMA dice que el contrato de privatización de la red eléctrica "no necesita enmiendas."](#) March 25, 2021.

⁹ El Nuevo Día. [LUMA Energy promete que no habrá alza en tarifa por cuenta de ellos en tres años](#). February 21, 2021.

- First, LUMA’s budget makes no provision for repaying the \$894 million commonwealth loan that the FOMB has stated is necessary for PREPA to effectuate the transaction.
- Second, LUMA’s budget appears to be artificially constructed to meet the constraint of not raising rates. That is, in order to keep its Transmission & Distribution System Operational budget within current rates, LUMA assumes a certain level of cost savings due to “efficiencies.” By 2024, these “efficiencies” are saving \$110 million, or about 10% of LUMA’s total budget (excluding federally funded capital expenditures).¹⁰ LUMA provides no explanation of where these savings are to come from, other than a vague mention of “loss reduction.” There is also very little consequence to LUMA if they do not achieve these savings. If LUMA fails to stay within budget, its annual incentive payment would only be reduced by about \$1 million.
- Third, LUMA’s budget makes optimistic assumptions about the costs of PREPA’s Title III bankruptcy process, which are passed on to customers in rates. The budget assumes a total of \$58.7 million in Title III and FOMB advisor costs in FY 2022.¹¹ This is an order of magnitude less than the FOMB’s claim in December 2020 that PREPA will have to fund \$500 million in Title III exit costs.¹² While IEEFA has commented on the excessive legal and consulting fees involved in PREPA’s debt restructuring process, it is unrealistic to expect this to change without a major change to the accountability structure for professional consultants, a problem that LUMA does not give any indication of being aware of.

Federal funding plans do not include renewable energy

PREPA’s most recent version of its 10-Year Infrastructure Plan calls for spending \$853 million of FEMA funds for new natural gas infrastructure, and \$11 billion to strengthen and harden the centralized transmission and distribution system. It includes no money for renewable energy or storage.¹³

Meanwhile, LUMA has already stated its interest in subcontracting federally funded grid reconstruction work to its corporate affiliates. There are two concerns here: 1) Will LUMA conduct bids competitively to give Puerto Rico the best price options, and 2) Can the company be depended on to help Puerto Rico meet its renewable energy goals?

Flaws in the LUMA Energy contract identified in IEEFA’s October 2020 report

Finally, I want to summarize the key points of IEEFA’s October 2020 report on the LUMA contract:

- First, the oversight and governance structure is poorly designed, and the responsible agencies have weak oversight priorities, poor track records, limited core competencies and resource constraints. They are improperly equipped to monitor and enforce this contract. Specifically, the contract provides for unclear division of responsibilities between the P3 Authority and the

¹⁰ LUMA Energy. Initial Budgets: First 3 Years of Recovery & Transformation. February 23, 2021, p. 36 and pp. 66-68.

¹¹ *Ibid.*, p. 69.

¹² Financial Oversight and Management Board. [Creditor Mediation Cash Support Materials](#). December 17, 2020, p. 24.

¹³ PREPA. [PREPA 10-Year Infrastructure Plan](#). Revised March 2021.

Puerto Rico Energy Bureau. The P3 Authority, which is the main entity responsible for oversight, has no experience or expertise in operating or overseeing a utility. It is concerning to me that LUMA is already resisting efforts of the Energy Bureau to exercise greater oversight over LUMA's invoices during the front-end transition period.¹⁴

- Second, the performance incentives built into the contract fail to address key reforms, including 1) the island's energy goal to move to 100% renewable energy; 2) the need for a rate of 20 cents/kWh; 3) specific goals related to workforce productivity initiatives or relations with labor; 4) adoption of budgets that are balanced and provide access to the capital markets; and 5) improving internal controls to prevent political hiring, favoritism in contract awards, excessive payments and to ensure timely, accurate financial reporting. At the same time, the contract has no provisions to prevent or penalize waste or failure to meet operational goals. LUMA has also recently proposed to defer or replace some of the performance metrics originally specified in the contract because of difficulty of getting baseline data.¹⁵
- Third, the decision to scrap the collective bargaining agreements of the PREPA unions was a poor management decision that has set up an unnecessary conflict with PREPA's workforce. Agreements between private grid operators and labor unions are common. The Long Island Power Authority's contract with private operator PSEG, often held up as a model for PREPA, explicitly recognizes the International Brotherhood of Electrical Workers.¹⁶ In a recent court proceeding between UTIER and the FOMB, FOMB expert witnesses acknowledged that in seven instances where labor and management had to agree to workforce changes during times of fiscal distress the final agreements included the protection of collective bargaining agreements. Quanta itself is party to collective bargaining agreements that cover approximately 35% of its workforce.¹⁷ Given the physical state of Puerto Rico's electrical system, PREPA's workforce is literally its most valuable asset. Union jobs with good salaries and benefits also are scarce on Puerto Rico and represent an important element of the island's shrinking middle class. The elimination of the PREPA unions and their collective bargaining agreements represents another self-inflicted wound to the Puerto Rico economy.
- Fourth, the LUMA co-venture between Quanta and ATCO consists of two companies with inadequate capitalization to raise private capital if federal funds fail to materialize, a possibility that is not contemplated in the contract at all. Quanta and ATCO have a combined market capitalization of \$11.9 billion. The estimated investment levels needed in Puerto Rico electrical infrastructure are in the \$20 billion range. ATCO is heavily leveraged. These companies are poorly positioned to raise additional dollars in the capital markets if the need arises.

Conclusion

The LUMA contract suffers from major flaws. The fact that the compromised procurement process for this contract was conducted by the same agency that is now the primary oversight entity for the

¹⁴ Puerto Rico Energy Bureau. [Resolution and Order, Case No. NEPR-MI-2020-0008](#). March 17, 2021.

¹⁵ LUMA Energy. [Submittal and request for approval of Revised Annex IX to the Puerto Rico Transmission and Distribution System Operation and Maintenance Agreement \(OMA\), Case No. NEPR-MI-2020-0025](#). February 25, 2021.

¹⁶ Long Island Power Authority. Amended and Restated Operations Agreement between Long Island Lighting Company (LILCO) d/b/a LIPA and PSEG Long Island LLC. December 31, 2013.

¹⁷ Quanta Services. [2019 Form 10-K](#). February 28, 2020, p. 5.

contract provides no confidence that the contract will be managed effectively. The contract does not advance Puerto Rico's renewable energy transition. It does not penalize LUMA for exceeding budgets or failing to meet operational goals. By abandoning its collective bargaining obligations, PREPA is breaking apart the one solid asset it has in its portfolio. Given the many hidden costs of the contract and the lack of accountability to achieve any level of savings, it is virtually certain that rates will go up, not down, under the contract. For all these reasons, the contract is not in the best interests of the people of Puerto Rico and should be cancelled.